(B) Repairing the most urgent defects on a priority basis to bring the Pipeline back to an acceptable level of technical integrity for the required throughput capacity; and

(C) Repairing leaks in the Pipeline to reduce technical losses.

(2) Engage one or more firms (the "***Energy Advisors***") to support the Ministry of Energy to further develop and implement its energy sector strategy, including, but not limited to, providing technical and feasibility studies essential for investment in regional transmission, gas-fired generation, and hydropower.

(ii) Outside Project Manager. MCC Funding will be used to engage, through a competitive international tender process acceptable to MCC, a project management firm as an Outside Project Manager to manage and supervise the rehabilitation of the Pipeline.

(c) Regional Infrastructure Development Activity.

(i) Sub-Activities. MCC Funding will be used to make grants ("***RID Grants***") to regional governments, local governments, local self-government units, municipal utilities and the central government (to the extent that it owns or operates assets in the Regions) (each an "***Eligible Governmental Entity***") for the following types of projects ("***RID Projects***"):

(1) For investment to improve and/or develop regional and/or municipal public infrastructure (including through cooperation with international and/or regional financial institutions) primarily in the water supply, sanitation, irrigation, municipal gasification, roads and solid waste sectors. Other sectors may be considered on a case-by-case basis; and

(2) For technical assistance to ensure sustainability of newly improved or installed infrastructure facilities by (A) addressing issues including tariff design, tariff collection, metering and general utility operations training in order to ensure adequate funding for operation and maintenance of the installed/rehabilitated infrastructure; and (B) building technical capacity of owners of the new or rehabilitated infrastructure assets.

(ii) RID Grant Size. MCC Funding for each RID Grant will be allocated in an amount not to exceed USD $7,000,000, with the exception of RID Grants for technical assistance for which the maximum amount may not exceed USD $500,000, except as may be otherwise agreed by MCC. With the exception of grants for technical assistance, the minimum amount of each RID Grant will be USD $500,000. Pooling of similar and contiguous projects will be allowed to meet the minimum allowable grant value. In instances where MCC Funding is used in parallel with other international and regional financial institutions, the MCC Funding portion shall not exceed the lesser of 35% of the total cost, or USD $7,000,000 per project.

(iii) RID Project Selection Criteria. To be eligible for MCC Funding, each proposal for a RID Grant must:

(1) Be submitted by an Eligible Governmental Entity and clearly show contribution to the economic and social development in the Regions;

(2) Be a priority for the Eligible Governmental Entity, the targeted area and the local population, as evidenced by citizen input through public hearings and/or other appropriate mechanisms for identifying needs and priorities;

(3) Be restricted to rehabilitation and repair of existing service infrastructure and/or development of new infrastructure required for service delivery. No funding will be provided for commercial enterprises, land acquisition, working capital or other operating budget support, or operations and maintenance;

(4) Outline a technically feasible, least cost approach to addressing a specific problem or need;

(5) Be projected to have a minimum real economic rate of return of not less than 15% or yield benefits that, using an agreed evaluation methodology acceptable to MCC, can be quantified or otherwise identified with an acceptable degree of certainty, as in the case of technical assistance projects;

(6) Be supported by an operations and maintenance plan and budget for a period of at least five years after completion of such RID Project;

(7) Be accompanied by a funding plan demonstrating that the ongoing costs of operations and maintenance for the proposed RID Project will be met:

(A) In whole or in part from user fees or similar charges generated by the proposed RID Project; and/or

(B) In whole or in part by the sponsoring Eligible Governmental Entity from its budget; and/or

(C) In whole or in part by the Government from its budget as set out in a commitment letter from the Government to the Eligible Governmental Entity or other satisfactory documentation.

The Eligible Governmental Entity may apply for technical assistance to assist it to satisfy this criterion;

(8) Be in full compliance with all relevant provisions of Georgian law and regulations, including environmental legislation;

(9) Be in compliance with MCC Environmental Guidelines;

(10) Be in compliance with MCC limitations on the use of funding; and

(11) Be in compliance with the operations manual (the "***RID Operations Manual***") acceptable to MCC.

(iv) <u>Implementing Entity Arrangement</u>. The Municipal Development Fund ("***MDF***"), the entity currently serving as the project implementation unit for the World Bank's Municipal Development and Decentralization Project II ("***MDDPII***"), will implement the Regional Infrastructure Development Activity. MCA-Georgia will enter into an Implementing Entity Agreement, called a Collaboration Agreement, with MDF through which it will retain approval rights necessary for it to ensure compliance with limitations on the use of MCC Funding, including approval of the RID Operations Manual. MCA-Georgia will also enter into a separate Service Agreement with the World Bank that sets out certain supervisory and technical support services to be provided by the World Bank in furtherance of the Collaboration Agreement. MCA-Georgia will approve the RID Operations Manual which will provide the MDF supervisory board and the management of MDF with the policies and procedures to be followed during implementation of the Activity. The Government will ensure that MCA-Georgia will obtain and maintain a seat on the MDF supervisory board.

3. Beneficiaries.

(a) <u>Road Rehabilitation Activity</u>.

The principal beneficiaries of the Road Rehabilitation Activity are expected to be the rural/regional population located in and near the Samtskhe-Javakheti region through which the majority of the road traverses. Specific beneficiaries include (i) farmers who use the road to get products to market, (ii) domestic commercial freight transport operators, (iii) international shippers, (iv) users of public transport, (v) private business and tourist travelers, and (vi) service industries supporting transportation and tourism. The population of this region is expected to benefit from enhanced agricultural and trade opportunities afforded them by an improved road. Other benefits include improved access to education, healthcare and employment. The entire population is expected to benefit from improved decision-making, planning and policy-making that may result from the road master plan and RDMED technical assistance.

(b) <u>Energy Rehabilitation Activity</u>.

Beneficiaries include households, businesses and industrial enterprises throughout Georgia that consume gas or electricity. Rehabilitation will improve a situation which currently endangers the environment as well as the health and safety of the population. Another benefit may be carbon credit revenue which may be secured as a result of reduced greenhouse gas emissions related to Pipeline rehabilitation. In addition, the financial condition of GGIC, the Pipeline operating company, will be improved through reduced technical losses and improved cash flow. All energy consumers located throughout Georgia are expected to benefit from implementation of the Government's energy strategy with the assistance of the Energy Advisors' services.

(c) Regional Infrastructure Development Activity.

The immediate beneficiaries of the Regional Infrastructure Development Activity are expected to be Eligible Governmental Entities, which will manage the provision of improved services to their citizens through local infrastructure projects such as water supply, sanitation, irrigation, municipal gasification, roads and solid waste. The long-term principal beneficiaries of the Activity include the users of the services in localities in which the Activity funds investment.

4. Donor Coordination; Private Sector; Civil Society.

(a) Road Rehabilitation Activity.

(i) World Bank. The World Bank is currently financing a Secondary and Local Roads Project for approximately USD $40,000,000 with a USD $15,000,000 contribution from the Government focused on rehabilitating 500-750 kilometers of paved secondary and local roads. Included in the current and previous World Bank road sector projects is (1) a component to strengthen the management, supervisory and road maintenance capacity of the RDMED; (2) institution building, policy reform, and restructuring of the Ministry of Transport; (3) improving access on the primary road network and (4) institutional strengthening of the Georgian transport agencies. The Road Rehabilitation Activity will complement the World Bank project by further improving the Georgian road network.

(ii) European Bank for Reconstruction and Development ("*EBRD*"). EBRD is contemplating parallel financing of the rehabilitation of certain road segments (such as Akhalkalaki to Lake Tabatskuri and Lake Tabatskuri to Bakuriani) in the Samtskhe-Javakheti region that connect with segments to be funded under the Road Rehabilitation Activity, which would deepen the potential for economic growth in the region. EBRD may also provide technical assistance for commercialization of operations and maintenance for RDMED.

(iii) Other Donors. The Kuwait Fund for Arab Economic Development has provided Kuwait Dinar 5,000,000 (approximately USD $15,000,000) for the upgrade, rehabilitation, and reconstruction of approximately 100 km of international roads in Georgia. The Kuwait Fund is currently evaluating an additional assistance program for the upgrade of roads in Tbilisi, which would complement the Road Rehabilitation Activity network outside of Tbilisi.

(b) Energy Rehabilitation Activity.

The possible availability of MCC Funding has raised the interest of the donor community in participating in rehabilitation of the Pipeline.

(i) World Bank. The World Bank is currently implementing an Energy Transit Institution Building Project. From this, the World Bank is contemplating providing approximately USD $830,000 to the Government for project preparation activities related to the Pipeline.

(ii) EBRD and IFC. In 2003, EBRD and IFC provided upwards of USD $220,000,000 each in syndicated loans to the private sector developers of the Baku-Tibilisi-Ceyhan Crude Oil Pipeline and the South Caucasus Pipeline, both of which traverse Georgia. EBRD has expressed interest in providing additional assistance related to the Pipeline rehabilitation, if MCC Funding is realized.

(iii) Other Donors and Sources of Funding. If MCC Funding is realized, additional World Bank and/or other funding to support further rehabilitation may be available from the purchase of carbon credits associated with the reduction of methane leakage resulting from the rehabilitation of the Pipeline.

BP, an international oil and gas company with investments in Georgia, is expected to participate in the preparatory surveys for the Pipeline rehabilitation under a separate grant (approximately USD $500,000).

In addition to the World Bank and EBRD, many other donors such as USAID and KfW have supported the electricity sector for the past decade. Assistance has been provided to support sector reform and restructuring, creation of a regulatory body, rehabilitation of plant and equipment and purchase of emergency energy supply. The engagement of Energy Advisors with MCC Funding represents an extension of such assistance and is complementary to the ongoing work of a very active and energy-focused donor group.

(c) Regional Infrastructure Development Activity.

(i) USAID. USAID/Georgia currently does not undertake large infrastructure projects in Georgia. Their efforts in infrastructure have been primarily in the energy sector and rehabilitation of small, local community infrastructure, such as schools and health care facilities, as part of their rural programs.

(ii) World Bank. The World Bank currently funds small scale infrastructure projects proposed by local governments through its credit facility, MDDPII. This credit is based on an assessment of the creditworthiness of municipalities and thus has limited applicability to poorer regions. The Regional Infrastructure Development Activity would increase the availability and reach of financing through its grant mechanism and also ensure close coordination on local infrastructure investments, as the MCC Funding and the World Bank loans would be managed by the same administrative unit, the MDF.

(iii) EBRD. EBRD's main operational objectives in Georgia for 2004-2005 complement those of the Regional Infrastructure Development Activity and EBRD has prepared a number of projects which may be candidates for parallel funding under this Activity.

(iv) Other Donors. The World Bank, USAID, KfW and UNDP are working in the water sector through the Georgian Social Investment Fund. Efforts will be made to coordinate the Regional Infrastructure Development Project Activity and Georgia Social Investment Fund activities in the cities where both organizations are working.

5. Sustainability.

(a) Institutional Sustainability.

The implementation of the Regional Infrastructure Rehabilitation Project is designed to support the development of local capacity by providing Georgian professionals and institutions with experience in implementing the infrastructure projects, where appropriate, while maintaining tight fiduciary risk controls. It is anticipated that Georgian construction firms will be competitive as contractors or subcontractors in the bidding for construction packages in all three Project Activities.

The RDMED has received and continues to receive technical assistance from the World Bank to strengthen its capacity in engineering standards and data collection, works monitoring, road maintenance, traffic safety, and interaction and responsiveness with local communities. Such efforts will ensure the effectiveness of this body in overseeing and maintaining the Road as the ultimate owner and responsible entity once the Road Rehabilitation Activity is completed. MCC will provide technical assistance to the RDMED to build capacity in maintenance planning and contracting. The Road Rehabilitation Activity will also provide funding for the commissioning and development of a road master plan to aid in the prioritization of future road investment.

The development of GGIC capacity to prioritize and carry out Pipeline rehabilitation and maintenance works is an essential feature of the design of the Energy Rehabilitation Activity. Close coordination between MCC-funded contractors and GGIC staff during the Pipeline rehabilitation is expected to enhance capacity through on-the-job training. Energy sector generation and transmission sustainability will also be addressed by the Energy Advisors through supporting the Government to further develop and implement its energy sector strategy.

With respect to the Regional Infrastructure Development Activity, institutional capacity may be strengthened through direct technical assistance to the Eligible Governmental Entities applying for RID Grants. This assistance will allow for the establishment or improvement of service provision and could come in the form of assistance in the areas of financial management capability, tariff design, tariff collection, metering or general utility operations training.

(b) Financial Sustainability.

Proper budgeting and funding of maintenance activities is the key to financial sustainability of the Regional Infrastructure Rehabilitation Project. Lack of maintenance on the Samtskhe-Javakheti Road has resulted in its current dilapidated state and need for major rehabilitation; therefore, regular maintenance and a proper drainage system will be critical to ensuring the long-term impact and realization of benefits from the Road Rehabilitation Activity. As a condition precedent to the first disbursement for the Road Rehabilitation Activity in any fiscal year, MCC will require that a minimum budget be approved for the maintenance of all maintainable national roads and that prior year budgeted amounts have been spent for the intended purpose.

Similarly, the present condition of the Pipeline may be attributed, in large part, to the lack of maintenance over the last decade. The Pipeline rehabilitation and the satisfaction of the

associated conditions are intended to improve the financial sustainability of GGIC through reduced losses, increased revenue and improved cash flow. To promote financial sustainability of GGIC, MCC requires that: (i) in view of GGIC's outstanding tax liabilities, the Georgia Tax Restructuring Committee grant tax relief for past tax liabilities accrued through June 30, 2005 in the form of a fifteen year restructuring plan for such tax liabilities (including a five-year freeze and a ten-year payment period); and (ii) beginning in July 2007, the Georgian National Energy Regulatory Commission permits GGIC to withhold gas as payment in kind from its non-paying customers for transmission charges owed to GGIC, and GGIC will utilize this in-kind payment mechanism to the extent needed to ensure that collection rates (for all services provided) are at least 95% throughout the remainder of the Compact Term.

A lack of attention to maintenance is also seen at the level of local infrastructure where municipalities have consistently been unable to fund maintenance. The Regional Infrastructure Development Activity is intended to improve the financial sustainability of regional and municipal assets through the condition that MCC Funding will be provided only once it is evident that the necessary operations and maintenance of proposed investments will be funded either through user fees or similar charges generated from the RID Project, by the applicable Eligible Government Entity or by the Government.

Funding from MCC for the Regional Infrastructure Rehabilitation Project will depend on the satisfaction of all conditions precedent as set forth in the Disbursement Agreement for road maintenance, maintenance of the Pipeline, and the maintenance of other infrastructure assets funded through the Regional Infrastructure Development Activity.

(c) Environmental and Social Sustainability.

Overall environmental and social sustainability depend on proper implementation of Project safeguards. MCA-Georgia's Management Team will include an Environmental and Social Impact Manager ("***ESI Manager***") whose job will be to ensure that environmental and social mitigation measures (including occupational health and safety issues) are followed for all Project Activities in accordance with the provisions set forth in the Compact and other documents. The ESI Manager will serve as the point of contact for comments and concerns of Project affected parties regarding the implementation of all Project Activities under the Compact and lead the effort to find feasible resolutions to those problems. The ESI Manager will convene periodic public meetings to provide implementation updates and to identify and address public concerns. Should the issue of involuntary resettlement arise, the Regional Infrastructure Rehabilitation Project will be conducted in compliance with the World Bank Policy on Involuntary Resettlement.

6. Policy and Legal Reform; Procedural Changes or Regulatory Actions.

(a) The Parties have identified the following policy, legal and regulatory reforms and actions that the Government shall pursue in support, and to reach the full benefits, of the Regional Infrastructure Rehabilitation Project, the satisfactory implementation of which will be conditions precedent to certain MCC Disbursements as provided in the Disbursement Agreement:

(i) Related to the Road Rehabilitation Activity:

(1) Authorization of the use of road design and construction standards consistent with modern European geometrical and physical standards having international applicability, acceptable to MCC;

(2) Maintenance of the Project Road in accordance with measurable performance standards acceptable to MCC and the Government, including winter maintenance and snow removal to keep the Project Road open; and

(3) Prior to the first disbursement in any fiscal year, the Government will approve the road maintenance budget for routine and periodic maintenance for the maintainable road network the forthcoming fiscal year providing for funding of at least the amount set out below, and will expend such amounts for the intended purpose and make-up any budget shortfall from the prior year's road maintenance budget:

(A) fiscal year 2006: Georgian Lari ("***GEL***") 60 million;

(B) fiscal year 2007: GEL 70 million;

(C) fiscal year 2008: GEL 80 million;

(D) fiscal year 2009: GEL 90 million; and

(E) fiscal year 2010: GEL 100 million.

(ii) Related to the Energy Rehabilitation Activity:

(1) Prior to the first disbursement for Pipeline rehabilitation, the Ministry of Energy will provide documentation satisfactory to MCC outlining the Ministry's plans and strategy for resolving the following four issues currently facing GGIC: (A) Kazbegigazi non-payment to GGIC; (B) Tbilgazi non-payment to GGIC; (C) Physical gas losses by GGIC; and (D) GGIC's tax liabilities;

(2) Prior to the first disbursement for Pipeline rehabilitation, the Georgia Tax Restructuring Committee will have granted tax relief to GGIC, acceptable to MCC, for past tax liabilities accrued through June 30, 2005 in the form of a fifteen year restructuring plan for such tax liabilities (including a five-year freeze and a ten-year payment period);

(3) The Government shall not sell or transfer, or permit to be sold or transferred, the Pipeline and/or a controlling interest in the GGIC group (GGIC and its subsidiaries and affiliates) and shall not place or permit to be placed any Lien on the Pipeline, in each case until the expiration of the Compact Term, except as may be otherwise agreed by MCC in writing (the "***Non-Transfer Condition***");

(4) Prior to the each disbursement for Pipeline rehabilitation on or after July 1, 2007:

(A) GGIC will demonstrate in a form acceptable to MCC that it is maintaining the Pipeline in accordance with satisfactory standards agreed by MCC and the Government that cover the design and construction of gas networks ("***Agreed Standards***"); and

(B) GGIC will have obtained authorization, in a form acceptable to MCC, from the Georgian National Energy Regulatory Commission that allows GGIC, starting from July 1, 2007, to withhold gas as payment in kind from its customers for transmission charges owed to GGIC to the extent needed to ensure that collection rates (for all services provided) are at least 95% throughout the remainder of Compact Term; and GGIC will utilize this in-kind payment mechanism to the extent needed to ensure that collection rates (for all services provided) are at least 95% throughout the remainder of Compact Term;

(5) In the event that:

(A) The GGIC collection rate after July 1, 2007 is below 95% for two consecutive quarters throughout the Compact Term;

(B) GGIC does not maintain the Pipeline in accordance with the Agreed Standards; and/or

(C) The Government does not comply with the Non-Transfer Condition;

then:

(A) Prior to any further disbursement for Pipeline rehabilitation or for any other Project Activity, the Government agrees to reimburse promptly to MCC, in MCC's discretion, all or a portion of Compact Funding disbursed for the Pipeline; and/or

(B) MCC may suspend all or a portion of further disbursements in connection with the Pipeline rehabilitation and/or other Project Activities under the Compact.

(b) To improve its level of performance under the policy criteria identified in Section 607 of the Act and the MCA Eligibility Criteria and to support the Regional Infrastructure Rehabilitation Project, the Government will pursue the following legislative and policy reforms:

(i) Support GGIC to realize the sale of emission reductions in order to fund additional pipeline rehabilitation activities;

(ii) Undertake policy reform and improve legislation governing the infrastructure sectors, including adoption of user fees, as may be appropriate to cover the costs of operations and maintenance;

(iii) Develop, as part of the ongoing decentralization process, appropriate policies and/or legislation on local government budgeting;

(iv) Undertake measures to safeguard the rehabilitated infrastructure from any laws, regulations or policies that may undermine the results of individual projects, including those that adversely restrict local control over budgets for operations and maintenance; and

(v) Such other legal or policy reforms as may be needed to improve efficiency of the infrastructure sectors, including those that are identified through the ongoing consultative process.

SCHEDULE 2 to ANNEX I

ENTERPRISE DEVELOPMENT PROJECT

This Schedule 2 describes and summarizes the key elements of a regional business investment and development project in furtherance of the Enterprises in Regions Developed Objective (the *"Enterprise Development Project"*). Additional details regarding the implementation of the Enterprise Development Project will be included in the Implementation Plan and in relevant Supplemental Agreements.

1. Background.

With 53% of Georgia's population living in poverty and a majority of these impoverished households living in rural areas, the Government is committed to encouraging economic growth and poverty reduction, primarily in the Regions. Agribusiness, in particular, is a key driver of growth nationally, representing 18% of GDP, and in the Regions where farms and small enterprises engaged in agribusiness constitute an essential source of livelihoods. Other sectors, including tourism, represent substantial growth opportunities in the Regions. However, while the economy in Georgia has experienced significant growth during the past few years, the performance of the rural economy has stagnated.

Of particular concern is the agriculture sector, which accounts for one-quarter of Georgia's economic output and over 50% of employment. Georgia's diverse climatic zones and rich natural resources provide the potential for further development of the agriculture and agribusiness sectors, particularly in the Regions. With increased quantity and quality, Georgian agricultural products will better compete with imported food products, thereby improving the living standards of the rural poor. Yet businesses face problems with poor technology, processing, marketing, management skills, and credit access.

The lagging performance of the economy in the Regions and past political uncertainty have contributed to the reluctance of financial institutions and other investors to invest in risk capital. As a result, firms, particularly small and medium enterprises ("*SMEs*"), may not be able to obtain the risk capital they need to grow and may not generate enough cash-flow in the near-term to pay high interest rates on a typical loan (if any long-term loan is available) or may not have sufficient collateral to obtain a loan. Experience in other countries indicates the importance of SMEs to economic development and job creation.

The consultative process in Georgia identified a number of key constraints to growth of small and medium enterprises in the Regions. These include (i) insufficient access to long term risk capital on viable terms, (ii) lack of sophisticated company and investment management skills and corporate governance, (iii) inadequate laws and regulations, (iv) poor enforcement and (v) the need for improved agribusiness productivity, among other items.

2. Summary of Project Activities.

The Enterprise Development Project is designed to provide access to capital on viable terms, support policy reforms to improve the business environment and improve business and technical skills in farms and enterprises.

The Enterprise Development Project consists of two Project Activities:

- The Investment Fund Activity. The objective of the Investment Fund Activity is to increase investment in and improve the performance of SMEs, primarily in the Regions. The Project Activity will create a professionally and independently managed investment fund (the "***Georgia Regional Development Fund***" or "***GRDF***" or such other name as may be agreed by the Parties) to provide capital to SMEs, provide technical assistance for portfolio companies and identify legal and policy reforms to encourage further investment in SMEs.

- The Agribusiness Development Activity (the "*ADA*"). The objective of the ADA is to improve economic performance of agribusinesses. The ADA will accelerate the transformation from subsistence to commercial agriculture through technical assistance, targeted grants and market information. The ADA will provide technical assistance and grants to farmers and agribusinesses in critical value chains that supply agricultural products to the domestic market, as well as disseminate information on regional market prices and volumes.

The GRDF and the ADA will be managed separately, but they are intended to complement one another. For example, GRDF may invest in an entity receiving ADA technical assistance, or farmers may need technical assistance from ADA to take advantage of opportunities to supply products to a GRDF investee company in the processing industry. The managers of the GRDF and the ADA will meet on a regular basis to discuss potential synergies. Any decision-making by GRDF or ADA with respect to business opportunities with the other party will be undertaken as if GRDF and ADA were unrelated parties.

The following summarizes the Enterprise Development Project Activities. The M&E Plan (described in Annex III) will set forth anticipated results and, where appropriate, regular benchmarks at the Enterprise Development Project level and at each Project Activity level to monitor implementation progress. Performance against these benchmarks and the overall impact of the Enterprise Development Project and each Project Activity will be assessed and reported at regular intervals as specified in the M&E Plan or otherwise agreed by the Parties from time to time. The Parties expect that additional benchmarks will be identified during implementation of each Project Activity. Estimated amounts of MCC Funding for each Project Activity within the Enterprise Development Project are identified in Annex II of this Compact. Conditions precedent to each Project Activity and sequencing of the Project Activities shall be set forth in the Disbursement Agreement or other relevant Supplemental Agreements.

(a) Investment Fund Activity.

The Investment Fund Activity involves three sub-activities: (i) creation and capitalization of the GRDF; (ii) portfolio company technical assistance; and (iii) legal and policy environment support.

(i) Creation and Capitalization of GRDF.

MCC Funding will be used to capitalize a professionally and independently managed investment vehicle, to be known as the GRDF.

MCC and MCA-Georgia have agreed to an indicative term sheet as of the date of this Compact (the "***Indicative Term Sheet***"), containing the proposed terms of the GRDF (including its investment policy guidelines and governance structure) and which will form the expected basis for preparation of the final investment guidelines, governance structure and investment management selection, compensation and agreement, and all other terms of the GRDF (the "***Final Fund Documents***"). Because the Indicative Term Sheet represents indicative but non-binding terms, the provisions in the Final Fund Documents may differ from, and will supersede, those in the Indicative Term Sheet. As a Condition Precedent to Disbursement for the GRDF, the Final Fund Documents must be acceptable in form and substance to both MCC and MCA-Georgia.

The GRDF will include the following elements:

(1) Establishment and Term of GRDF.

(A) Following the satisfaction of conditions precedent contained in the Disbursement Agreement and in accordance with the Final Fund Documents, MCC Funding will be used to organize and establish the GRDF in a legal form and jurisdiction acceptable to MCC. All of the ownership interests in the GRDF are expected to be held initially by a trust (or similar structure acceptable to MCC and MCA-Georgia), the trustee (or similar) of which will be procured through a process acceptable to MCC and will be subject to MCC approval. MCC will be a third party beneficiary to the appropriate Final Fund Documents.

(B) The investment period of the GRDF shall run for five years from the Entry into Force, subject to an earlier termination upon termination of the Compact (the "***Investment Period***"). All MCC obligations shall terminate at the end of the Investment Period. GRDF is expected to exist for ten years, including a five year wind-down period after the termination of the Investment Period.

(C) Any distributions to the GRDF will be held for the benefit of beneficiaries to be agreed upon by MCC and MCA-Georgia prior to the end of the Investment Period. Any beneficiary or beneficiaries selected by MCC and MCA-Georgia must be a charitable, educational or other non-profit developmental entity in Georgia that benefits, in substantial part, citizens working in agribusiness and/or other enterprises outside of Tbilisi.

(2) Investment Objective. The primary objective of the GRDF will be to maximize developmental impact, as well as to earn a reasonable and positive financial return, from investments in SMEs in agribusiness, tourism and other sectors, primarily outside of Tbilisi.

(3) Permitted and Prohibited Investments. The GRDF will invest in equity, quasi-equity and debt (subject to limits specified in the Final Fund Documents) issued by enterprises that meet the definition of "permitted investments" ("***Permitted SMEs***"). The Final Fund Documents will have clear criteria for which types of investments are permitted and prohibited, as well as the process by which investment decisions are approved by the GRDF. These criteria will be set forth in the Final Fund Documents. Among the provisions that the Final Fund Documents must contain are the following:

(A) Permitted sectors. The Final Fund Documents will require a majority of capital to be invested in agribusiness or tourism, with approximately 33% of capital invested in agribusiness, unless otherwise agreed by the Parties.

(B) Location of businesses. The GRDF will invest primarily outside of Tbilisi; accordingly, the Final Fund Documents will limit the percentage of GRDF capital that can be invested in Tbilisi to 20% unless otherwise agreed by the Parties.

(C) Developmental and financial criteria. The pipeline of potential investments by the fund will be determined in accordance with criteria used to measure the developmental impact associated with the investment as well as financial rate of return.

(D) Maximum investment size. The Final Fund Documents will limit the maximum investment size of any one particular investment to 10% of the committed capital of the GRDF unless otherwise agreed by the Parties.

(E) Stage of Development of Portfolio Companies. The GRDF will invest primarily in existing businesses but may also

invest not more than 15% in start-ups, unless otherwise agreed by the Parties.

(F) Prohibited Investments. The Final Fund Documents will require compliance with (1) prohibitions on investments, including those that conflict with the limitations on the use of MCC Funding set forth in the Compact, and (2) environmental guidelines and environmental screening procedures (which will be based on MCC's Environmental Guidelines and specified in full in the Final Fund Documents). A full list of prohibited types of businesses will be included in the Final Fund Documents.

(4) Implementing Entity Arrangement; Governance Structure.

(A) Investment Manager. The GRDF will be managed by a professional, independent and qualified investment manager selected after a competitive tender conducted by the Procurement Agent ("***Investment Manager***"). MCC and MCA-Georgia will each have the right to approve the selection of the Investment Manager and the terms of the Investment Manager's contract, including auditing, reporting and termination provisions.

(B) GRDF Governing Board. The Investment Manager will report to an independent GRDF governing board ("***GRDF Governing Board***")comprised of individuals with financial and development experience acceptable to MCC and MCA-Georgia. MCC will be entitled to appoint one additional member of, or a non-voting observer on, the GRDF Governing Board. MCA-Georgia will also be entitled to appoint a non-voting observer on the GRDF Governing Board.

(C) Investment Committee. An investment committee ("***Investment Committee***") acceptable to MCC and MCA Georgia will be responsible for approving investments suggested by the Investment Manager and overseeing the monitoring and evaluation of the performance of those investments. MCC will have the right, in its discretion, to appoint one member, or one non-voting observer, to the Investment Committee.

(5) Relationship of GRDF to MCA-Georgia. All investment decisions will be made by the GRDF and the Investment Manager independently from MCA-Georgia and the Government.

(6) Operating Policies. The Final Fund Documents will include requirements for the GRDF's due diligence/investment process, conflicts policy, internal controls and auditing, and reporting, in each case acceptable to MCC.

(ii) Portfolio Company Technical Assistance Facility.

(1) Establishment. MCC Funding will be used for technical and managerial assistance (the "***Portfolio Company TA Facility***") to be applied by the Investment Manager to improve the performance of portfolio companies following investment or to assist prospective portfolio companies that then become qualified for GRDF investments. The financial resources of the Portfolio Company TA Facility will not be invested in the GRDF or considered part of the management fee or fund expenses. The Portfolio Company TA Facility proceeds will be drawn down by the Investment Manager through separate disbursement requests.

(2) Objective. The Portfolio Company TA Facility will complement the work of the Investment Manager by assisting in the growth and development of the portfolio investees. The Portfolio Company TA Facility is intended to pay, on a cost-sharing basis with investees, a portion of the costs of third-party consultants and other service providers (the "***Service Providers***") that would otherwise have been reasonably considered beyond the capacity of the investee or the obligation of the Investment Manager to pay.

(3) Selection Criteria. Each use of the Portfolio Company TA Facility funding shall be determined jointly by the investee and the Investment Manager on a demand-driven basis according to selection criteria acceptable to MCC. The use of the Portfolio Company TA Facility will be subject to the same statutory limits on the use of MCC Funding as the GRDF. Additional detailed Service Provider selection criteria, conflict of interest provisions, cost-sharing criteria, disbursement and reporting procedures, and further definitions of permitted and prohibited uses of TA Facility resources, shall be provided in the Final Fund Documents.

(iii) Legal and Policy Environment.

MCC Funding will be used to engage an expert to identify and support Georgians advocating for key legal and policy reforms affecting the investment environment and to establish and operate a mechanism for this analysis and advocacy. This is intended to be similar to venture capital industry groups in other countries that work with local, key stakeholders and donors to build consensus and advocate for reforms needed for successful risk capital investments. The expert would be supported by an advisory board of key stakeholders acceptable to MCC, such as the Investment Manager, other private equity funds and financial institutions, other private sector participants, donors, and others.

(b) Agribusiness Development Activity.

(i) ADA Establishment and Implementation.

The ADA is expected to contribute to poverty alleviation by accelerating agriculture sector transformation from subsistence production to profitable farms and rural enterprises directly participating in commercial value-chains. The ADA includes three separate sub-activities intended to support the development of Georgia's agriculture and agribusiness sectors.

The ADA will be set up and managed by a professional, independent and qualified manager, acceptable to MCA-Georgia and MCC, selected after a competitive tender (the "***ADA Manager***"). The competitive tender will be conducted by the Procurement Agent, with the assistance of an advisory panel, consisting of independent experts. MCC and MCA-Georgia will each have the right to approve the selection of the ADA Manager.

(ii) Access to Modern Technology.

MCC Funding will be used to provide modern technology to agribusiness processors in at least five agribusiness value-chains that have domestic market growth potential. For example, this could include the following types of activities:

(1) Developing the dairy industry through set-up of milk collection infrastructure to facilitate flow of quality raw product from small farms to processing plants that can better compete in the domestic market;

(2) Establishing private sector input supply centers that service productive yet hard to reach rural areas in order to increase higher value horticulture production for processors and the fresh market;

(3) Developing livestock production contracts with slaughter facilities that will establish the capacity to offer new, high-quality meat products into the growing domestic market;

(4) Facilitating investment in livestock feed processing and sales coupled with the beneficiary firm's financed livestock production agents to improve farm management; and

(5) Introducing new varieties and technology into the potato industry to produce and process products in direct response to domestic market demands.

(iii) Grants to Rural Enterprises.

MCC Funding will be used to provide grants (the "***Rural Enterprise Grants***") to groups of farmers and to private enterprises to apply innovative business solutions and technology to

significantly increase household and agribusiness net revenue through higher productivity, better financing, improved post harvest processing and marketing.

(1) Selection Criteria. An application for a Rural Enterprise Grant must be supported with a sound business plan. Applications should be for equipment or supplies and matched with direct grantee investment in land, facilities, labor or additional equipment. Rural Enterprise Grants will range in value from USD $5,000 to USD $50,000, unless otherwise agreed by the Government and MCC. Rural Enterprise Grants will be made in three categories:

(A) Primary production. Innovative agriculture production technology and practices and development of business linkages of farmers with processors or directly with the market;

(B) Service providers. Introduction or expansion of input provision of seed, feed, fertilizer, new varieties, equipment leasing, best practices and better farm management among cooperatives and associations; and

(C) Value adding enterprises. Transfer of technology to add value to raw product through small scale processing equipment, quality assurance systems, processing, packaging, and competitive domestic marketing.

(2) Selection Procedure. A call for applications for Rural Enterprise Grants will be announced by the ADA Manager during the first quarter of each year with clear guidelines and evaluation criteria. The ADA Manager will be responsible for developing award selection criteria, subject to MCA-Georgia and MCC approval. The ADA Manager will establish an independent grant award committee acceptable to MCC and MCA-Georgia that will review grant applications and make grant awards.

(iv) Market Information.

MCC Funding will support a market information campaign that disseminates information to the agriculture and food industry. The market information campaign will:

(1) Inform rural households and stakeholders about ADA objectives and guidelines for targeted technical assistance and grants;

(2) Broadcast information on innovations, best practices, and new technology, and highlight "model" farmers' or entrepreneurs' success stories; and

(3) Produce regular reports on farm gate price and volumes of commodity sold from several regional marketing hubs throughout the country including market news/trends of business significance.

3. Beneficiaries.

The principal direct beneficiaries of the GRDF are expected to be SMEs in agribusiness and other sectors in the Regions (and, to a limited extent, Tbilisi) needing risk capital to expand, agricultural producers and other local suppliers doing business with those SMEs, and farmers and rural households in the Regions employed by SMEs or related businesses. Certain activities in the GRDF, such as advocacy for legal and policy reform, will have national scope and impact.

The objective of the ADA is to significantly improve capacities of rural households to engage and benefit from direct participation in the commercial economy. Therefore, the principal direct ADA beneficiaries are rural households that are dependent on agriculture and agribusiness for their livelihood. These are primarily small farmers and SMEs that deliver services to farmers and process raw product. As a result of ADA, over 50,000 rural participants are expected to benefit either directly or indirectly.

4. Donor Coordination.

The Enterprise Development Project complements other donor supported projects, including projects by EBRD, IFC, World Bank, USAID and USDA. The goal and structure of the GRDF is significantly different from those of other donor-supported investment activities. The GRDF will be encouraged to work with other donors' financial institutions to attract capital and expertise to the SME sector in the Regions, especially to businesses in which such institutions may have been reluctant to invest in the absence of the GRDF in Georgia. The ADA is uniquely focused on rural household economic growth and will be reinforced by current activities that foster economic growth in agriculture. Specifically, Enterprise Development Project synergies with key U.S. agencies and other donors are as follows:

(a) Investment Fund Activity.

(i) IFC. IFC is conducting a business development project that focuses on areas such as strengthening corporate governance and encouraging lease financing, as well as an initiative to determine the state of SME development in Georgia and significant legal and other barriers facing Georgian SMEs. Although IFC has previously sponsored investments in businesses in Georgia, the target internal rates of return and sizes of investments have exceeded the typical investment the GRDF is expected to pursue. The IFC business development efforts will complement and reinforce the Investment Fund Activity's efforts to improve the business climate.

(ii) EBRD. EBRD has established several debt and equity investment facilities that can invest in Georgia. EBRD has also established business consulting services using local consultants that offer their services to Georgian businesses at rates partly, and temporarily, subsidized by EBRD. The Investment Manager may (but is not required to) utilize these consulting services when applying technical assistance to one of the portfolio companies. The investment facilities may provide another source of capital for the GRDF's portfolio companies.

(iii) OPIC. There are several OPIC funds that are eligible to invest in Georgia, among other countries. However, the sizes and types of investments that these funds generally pursue differ from, and are larger than, those that the GRDF is expected to pursue. Moreover, OPIC guarantees debt issued by these funds, while MCC Funding would be used as the source of equity capital for the GRDF.

(iv) USAID. The GRDF will complement USAID's financial sector and agricultural activities. These have included AgVantage, the Georgia Enterprise Growth Initiative, the Georgia Microfinance Stabilization and Enhancement activity, the Land Market Development Project, and the banking infrastructure strengthening program to assist the National Bank of Georgia.

(b) Agribusiness Development Activity.

(i) USAID. Of particular relevance to the objectives of the ADA is the USAID-funded project called AgVantage. This activity focuses on developing agricultural export markets and strategic interventions to overcome barriers to increase export sales of agriculture and food products. Later this year, AgVantage will also begin work in policy analysis, legal drafting, training, and limited administrative support to the Ministry of Agriculture and will put in place policies which promote and support the development of private sector agribusiness. The ADA is interested in supporting these efforts and participating in constructive dialogue with the Ministry of Agriculture to create a more conducive environment for private business development.

(ii) USDA. A transition program is underway by USDA/ICD in Georgia. Previous project activity provides opportunities for ADA to build upon progress made, especially in developing meat slaughterhouses and dairy processing in several regional locations. The new focus of USDA's program will most likely include assistance to the Ministry of Agriculture in seed and plant material certification and multiplication, quality assurance capabilities and veterinary inspection services, which complements ADA.

(c) Both Project Activities.

(i) World Bank/IFAD. A new Rural Development Loan has been approved, with a portion to be used to flow through commercial banks and multilateral financial institutions as credit for agribusiness investments. This loan will provide a source of debt finance for businesses that has terms and characteristics different from many of the risk capital investments the GRDF will pursue. Discussions with World Bank and IFAD representatives generated collaborative ideas for loan preparation training and technical assistance to prospective borrowers through the ADA grant program. Also, IFAD has established four regional "Farm Houses" which support a variety of services to farmers including equipment leasing, extension, and input sales. Proposals from the leadership of a Farm House to expand to ADA clients will be encouraged.